

Stern Advice: When you lose money while you sleep



Credit: Reuters

By [Linda Stern](#)

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(Reuters) - Anyone who invests in individual stocks should be aware that they could lose - a lot - while they are sleeping.

One recent morning, shareholders awoke to learn that Internet 2.0 darling Groupon had dropped 11 percent from its previous close before it even opened. Another popular networking site, TripAdvisor, dropped 17 percent. The big loser that same night was Diamond Foods, which announced a management shakeup and an accounting problem after the market closed. It lost 41.4 percent of its value before it opened the next morning.

That's a really frightening overnight scenario. Even though stock exchanges might be officially closed, extended trading allows investors to buy and sell for several hours in the evening and at least an hour in the morning. Good and bad news -- [earnings](#) reports, downgrades, big contracts -- can cause big reactions in company share prices.

What can investors do about it? Precious little. Here are some tips from the pros.

-- Start by buying stocks that are a little bit safe. It's pretty impossible to predict when a company will have an accounting mess on its hands, but it's easier to choose companies that have what Morningstar analysts like to call "a moat." Companies that aren't expensive relative to their earnings, and that are less volatile than the market in general have a bit of a moat.

Paul Larson, an equities expert at Morningstar, tells investors to pay special attention to balance sheets. "Companies that don't have debt, don't go bankrupt," he said. So companies like that still might lose money overnight, but they won't lose all.

-- Buy the right number of companies. If all you invest in are individual stocks, you should own between 20 and 30 companies, suggests Pat Dorsey of The Sanibel Captiva Trust Company, a money management firm. For individual investors who are not professionals, it's better to diversify via mutual funds or exchange traded funds, and buy only a few individual companies to supplement that.

"Fewer is better because that way you can really get to know the companies; you can listen to conference calls, read the reports and make more rational decisions," he said.

-- Don't try to stay up late trading yourself. Extended hours trading tends to be thin and volatile, so you are unlikely to get a good price for your shares anyway.

"You're going to receive a very poor execution," says Dorsey. Furthermore, those extended market traders may also be panicking and overreact, overselling a stock that's merely had an earnings blip. Charles Rotblut, of the American Association of Individual Investors, tells members they shouldn't even start trading for the first 30 minutes after the market opens in the morning. "Let the initial volatility work itself through, and then you can get a better sense of where the stock is."

-- Don't bother to set stop-loss orders. That's a strategy sometimes recommended to investors who own a lot of shares of a stock they are emotionally attached to, or one that has gone up considerably. It puts in an automatic order to sell when shares drop below a certain level. But that can backfire: If your shares take a deep dive and then recover, you can end up automatically selling a stock you don't even want to sell at a price well below where it ends up. Furthermore, stop-loss orders don't get triggered by price changes in extended-hours trading, so setting one up wouldn't help you in an after-hours meltdown.

-- Decide whether to hold shares on the merits. If you wake up one morning and one of your stocks has given up big ground overnight, don't sell - or buy - in a knee-jerk reaction. Decide whether the company still has the same long-term outlook you originally had in mind when you bought it. If so, hold on, or use the sell-off to buy more. If something big and bad happened and you no longer like the company, sell. You won't get out at the top, but chances are you won't get out at the bottom either. For example, Groupon, which closed on February 8, 2012, at \$24.58 a share, and opened the following morning at \$21.68 a share, is now selling at just over \$19.

-- Just suck it up. Most experts say that losing money while you sleep is just one of the risks you take when you buy individual stocks. "That's why you get a higher return with stocks than with bonds," says Dorsey.

Get used to it, or do something else with your money. And sleep tight.

(The Stern Advice column appears weekly, and at additional times as warranted. Linda Stern can be reached at linda.stern@thomsonreuters.com; She tweets at www.twitter.com/lindastern;